

**COUNTY OF SAN BERNARDINO**  
**ARROWHEAD REGIONAL MEDICAL CENTER**  
(A Component Unit of the County of San Bernardino, California)

**BASIC FINANCIAL STATEMENTS**

**WITH AUDITORS' REPORT**

**JUNE 30, 2007 AND 2006**

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**JUNE 30, 2007 AND 2006**

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## INDEPENDENT AUDITORS' REPORT

The Honorable Board of Supervisors  
County of San Bernardino, California

We have audited the accompanying financial statements of the Arrowhead Regional Medical Center (the Medical Center), a component unit of the County of San Bernardino (the County), as of and for the years ended June 30, 2007 and 2006, as listed in the accompanying table of contents. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 of the notes to the financial statements, the financial statements present only the Medical Center and do not purport to, and do not, present fairly the financial position of the County as of June 30, 2007 and 2006, and the changes in its financial position and cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Medical Center as of June 30, 2007 and 2006, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 20, 2007 on our consideration of the Medical Center's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The Medical Center has not presented management's discussion and analysis that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements.

*Varemark, Trine, Day & Co., LLP*

Rancho Cucamonga, California  
November 27, 2007

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**STATEMENTS OF NET ASSETS**

**JUNE 30, 2007 AND 2006**

**(In Thousands)**

	<u>2007</u>	<u>2006</u>
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 34,422	\$ 39,267
Patient accounts receivable, net of estimated uncollectibles of \$226,423 in 2007 and \$262,871 in 2006	35,580	36,043
Due from third-party payors	6,067	7,592
Receivable from other governments	11,428	10,602
Due from County	1,526	2,222
Supplies inventories	1,579	1,401
Prepaid expenses and other assets	2,776	3,209
Total Current Assets	<u>93,378</u>	<u>100,336</u>
Noncurrent Assets		
Assets whose use is limited, investments	59,019	59,028
Assets whose use is limited, interest receivable	1,002	705
Capital assets, net of accumulated depreciation of \$186,792 in 2007 and \$168,540 in 2006	433,150	443,096
Deferred issuance costs	7,831	8,460
Total Noncurrent Assets	<u>501,002</u>	<u>511,289</u>
Total Assets	<u>594,380</u>	<u>611,625</u>
<b>LIABILITIES</b>		
Current Liabilities		
Accounts payable	13,365	12,176
Accrued salaries and benefits	20,809	18,732
Other accrued liabilities	503	446
Capital lease obligations	1,665	844
Certificates of participation	27,180	25,735
Interest payable	11,996	12,584
Arbitrage payable	264	191
Due to County	13,950	3,430
Total Current Liabilities	<u>89,732</u>	<u>74,138</u>
Noncurrent Liabilities		
Capital lease obligations, less current installments	2,471	1,594
Certificates of participation, less current installments (net of deferred amount of refunding and bond discount)	490,379	515,317
Total Noncurrent Liabilities	<u>492,850</u>	<u>516,911</u>
Total Liabilities	<u>582,582</u>	<u>591,049</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	(80,714)	(91,934)
Restricted for debt service	47,023	46,444
Unrestricted	45,490	66,066
Total Net Assets	<u>\$ 11,799</u>	<u>\$ 20,576</u>

See accompanying notes to basic financial statements.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**

**YEARS ENDED JUNE 30, 2007 AND 2006**

**(In Thousands)**

	2007	2006
<b>OPERATING REVENUES</b>		
Net patient service revenue	\$ 375,973	\$ 345,923
Premium revenue - managed care	9,059	8,650
Other	4,468	4,497
Total Operating Revenues	389,500	359,070
<b>OPERATING EXPENSES</b>		
Salaries and benefits	191,779	175,325
Medi-Cal matching fund expense	31,327	24,509
Medical claims expense	2,555	1,822
Supplies	64,106	63,717
Professional services	38,518	36,697
Purchased services	28,517	26,124
Insurance	7,745	8,839
Provision for bad debts	56,040	31,175
Utilities	7,126	6,806
Depreciation and amortization	18,251	18,241
Rent	4,650	3,758
Amortization related to debt	2,871	2,871
Other	1,186	1,154
Total Operating Expenses	454,671	401,038
Operating Loss	(65,171)	(41,968)
<b>NONOPERATING REVENUES (EXPENSES)</b>		
State debt service funding	26,594	21,521
State realignment funding	46,387	69,283
Federal grants	382	
Tobacco tax	735	495
Investment income	3,460	333
Interest expense on debt	(28,423)	(30,313)
Other nonoperating expenses	(725)	(740)
Total Nonoperating Revenues, Net	48,410	60,579
Income (Loss) Before Transfers	(16,761)	18,611
Transfers from the County	17,960	24,365
Transfers to the County	(9,977)	(2,881)
Changes in Net Assets	(8,778)	40,095
Net Assets (Liabilities), Beginning of Year, as Restated	20,576	(19,519)
Net Assets, End of Year as Restated	\$ 11,799	\$ 20,576

See accompanying notes to basic financial statements.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**STATEMENTS OF CASH FLOWS**

**YEARS ENDED JUNE 30, 2007 AND 2006**

**(In Thousands)**

	<u>2007</u>	<u>2006</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 335,318	\$ 321,400
Payments to suppliers	(173,636)	(182,063)
Payments to employees	(189,702)	(172,742)
Net Cash Used in Operating Activities	<u>(28,020)</u>	<u>(33,405)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
State realignment funding received	46,387	69,283
Tobacco tax received	735	495
Transfers from the County	17,960	24,365
Transfers to the County	(9,977)	(2,881)
Other nonoperating income (expense)	(343)	(740)
Net Cash Provided by Noncapital Financing Activities	<u>54,762</u>	<u>90,522</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
State debt service funding	26,594	21,521
Purchase of capital assets	(8,305)	(2,700)
Proceeds from capital lease obligations	3,042	1,678
Principal payments on capital lease obligations	(1,344)	(544)
Principal payments on certificates of participation	(25,735)	(24,350)
Interest paid on debt	(29,011)	(30,869)
Net Cash Used in Capital and Related Financing Activities	<u>(34,759)</u>	<u>(35,264)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest on investments	3,460	333
Investment activity, net	(288)	2,084
Net Cash Provided by Investing Activities	<u>3,172</u>	<u>2,417</u>
Increase in Cash and Cash Equivalents	(4,845)	24,270
Cash and Cash Equivalents, Beginning of Year	<u>39,267</u>	<u>14,997</u>
Cash and Cash Equivalents, End of Year as Restated	<u>\$ 34,422</u>	<u>\$ 39,267</u>

See accompanying notes to basic financial statements.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**STATEMENTS OF CASH FLOWS, Continued**

**YEARS ENDED JUNE 30, 2007 AND 2006**

**(In Thousands)**

	<u>2007</u>	<u>2006</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES		
Operating Loss	\$ (65,171)	\$ (41,968)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	18,251	18,241
Amortization related to debt	2,871	2,871
Provision for bad debts	56,040	31,175
Decrease (Increase) in:		
Patient accounts receivable	(55,577)	(40,845)
Due from third-party payors	1,525	(3,753)
Receivables from other governments	(826)	6,966
Due from County	696	(38)
Supplies inventories	(178)	70
Prepaid expenses and other assets	433	(1,089)
Increase (Decrease) in:		
Accounts payable	1,189	(306)
Accrued salaries and benefits	2,077	2,583
Other accrued liabilities	57	75
Arbitrage payable	73	26
Due to County	10,520	(7,413)
Net Cash Used in Operating Activities	<u>\$ (28,020)</u>	<u>\$ (33,405)</u>

See accompanying notes to basic financial statements.



**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

***NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES***

**A. General**

The County of San Bernardino (County) Arrowhead Regional Medical Center (Medical Center) is classified as a level II trauma center with eight trauma bays and four additional "swing" trauma rooms that can be used during an emergency. In addition, the Medical Center provides 373 patient beds and has 24 private treatment rooms for diagnosis and treatment of urgent care patients. During fiscal year 2000, the Medical Center assumed the inpatient operations, consisting of 90 beds, from the previously separate Department of Behavioral Health.

The Medical Center is owned by the County, which is a legal subdivision of the state of California charged with governmental powers, and is reflected in the County's comprehensive annual financial report as an enterprise fund. The County's powers are exercised through the Board of Supervisors, which, as the governing body of the County, is responsible for the legislative and executive control of the County.

These financial statements present only the Medical Center and do not purport to, and do not, present fairly the financial position of the County and the changes in its financial position and cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

**B. Basis of Accounting**

The basic financial statements of the Medical Center are presented using the economic resources measurement focus and the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenues are recognized in the period in which they are earned and become measurable. Expenses are recognized in the period in which they are incurred.

Operating revenues include those generated from direct patient care and related support services. Operating expenses include the cost of providing patient care, administrative expenses, and depreciation on capital assets. Revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

**C. Accounting Standards**

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Medical Center has elected not to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989. The Medical Center applies all applicable GASB pronouncements, as well as statements and interpretations of FASB, the Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure, issued on or before November 30, 1989, unless those pronouncements conflict or contradict GASB pronouncements.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

*NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)*

**D. Income Taxes**

The Medical Center is owned and operated by the County and is exempt from federal and state income tax pursuant to IRC Section 115 and similar provisions of the California Franchise Tax Code and is also exempt from federal and state income tax filing requirements.

**E. Charity Care**

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at an amount less than its established rates. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. However, the Medical Center monitors the level of charity care provided. See Note # 5.

**F. Net Patient Service Revenue**

Net patient service revenue is recorded at established rates less contractual allowances from third-party payors, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

**G. Premium Revenue - Managed Care**

The Medical Center has agreements with Inland Empire Health Plan (IEHP) and Foundation Health to provide medical services to subscribing participants. Under these agreements, the Medical Center receives monthly capitation payments based on the number of participants, regardless of services actually performed by the Medical Center.

Premium revenue is recognized in the period in which participants are entitled to health care services.

**H. Cash**

The Medical Center maintains a certain portion of its cash on deposit with the County Treasurer.

**I. Assets Whose Use is Limited**

Assets whose use is limited represent funds held by a trustee which are legally restricted for bond reserve accounts. Assets whose use is limited that are required for obligations classified as current liabilities are reported as current assets.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

*NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)*

**J. Capital Assets**

Buildings, improvements, and equipment with a historical cost over \$5,000 are capitalized. Contributed capital assets are reported at their estimated fair value at the date of donation. Depreciation expense is provided using the straight-line method over the estimated useful lives of the respective classes of capital assets. Equipment under capitalized leases is amortized using the straight-line method over the lesser of minimum lease terms or estimated useful lives. The estimated useful lives for computing depreciation expense are as follows:

Buildings	40 Years
Improvements	3 to 25 Years
Equipment	5 to 20 years

**K. Capitalized Interest**

The Medical Center capitalizes net interest expense as a cost of property constructed. No amounts were capitalized for the years ended June 30, 2007 and 2006.

**L. Supplies Inventories**

Supplies inventories are recorded at the lower of average cost or market.

**M. Net Assets**

Net assets of the Medical Center are classified in three components. *Net assets invested in capital assets net of related debt* consist of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted net assets* are noncapital assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center. Restricted net assets are reduced by any liabilities payable from restricted assets. *Unrestricted net assets* are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

**N. Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006

(Dollar Amounts in Thousands)

NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)

O. Reclassification of Prior Year Amounts

Certain prior year amounts in these financial statements were reclassified to conform to the current year presentation.

P. New Accounting Pronouncements

**Governmental Accounting Standard No. 48**

In September 2006, the GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. This Statement establishes criteria that governments will use to ascertain whether the proceeds received from the sales and pledges of receivables should be reported as revenue or as a liability. This Statement also includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. Therefore, any assets (or future revenues) sold or donated within the same financial reporting entity should continue to be reported at their current carrying value when those assets or future revenues are transferred. This Statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions. The disclosures pertaining to future revenues that have been pledged or sold are intended to provide financial statement users with information about which revenues will be unavailable for other purposes and how long they will continue to be so. The requirements of this Statement are effective for financial statements for periods ending on June 30, 2008. The Medical Center has not determined its effect, if any, on the financial statements.

**Governmental Accounting Standard No. 49**

In December 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of *existing* pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the document excludes pollution *prevention* or *control* obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning. The requirements of this Statement are effective for financial statements for periods ending June 30, 2009. The Medical Center has not determined its effect, if any, on the financial statements.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

**NOTE #1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)**

**Governmental Accounting Standard No. 50**

In May 2007, the GASB issued Statement No. 50, *Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27*. This Statement more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits (OPEB) and, in doing so, enhances information disclosed in notes to financial statements or presented as required supplementary information (RSI) by pension plans and by employers that provide pension benefits. This Statement is effective for periods ending June 30, 2008. The Medical Center has not determined its effect, if any, on the financial statements.

**Governmental Accounting Standard No. 51**

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. This Statement requires that an intangible asset be recognized in the statement of net assets only if it is considered identifiable. This Statement also establishes guidance specific to intangible assets related to amortization. This Statement provides guidance on determining the useful life of intangible assets when the length of their life is limited by contractual or legal provisions. The Medical Center has not determined its effect, if any, on the financial statements.

**NOTE #2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS**

The Medical Center maintains a certain portion of its cash with the County Treasury for investment purposes to maximize interest earnings. Interest on the pooled funds is allocated based on the Medical Center's average daily balance. The Medical Center's share of the investment activity in the pooled funds managed by the County is not material to the total held by the County. The equity in the County Treasury is carried at fair value based on the value of each participating dollar as provided by the County Treasurer. The fair value of the County Treasury pool was approximately \$3,407,885 at June 30, 2007. The County Treasury pool did not include any derivative securities in 2007.

Investment policies and related credit, custodial credit, concentration of credit, interest rate and foreign currency risks applicable to the Medical Center's pooled funds are those of the County and are disclosed in the County's basic financial statements.

The Medical Center's cash and assets whose use is limited as of June 30, 2007 and 2006 are classified in the accompanying financial statements as follows:

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

*NOTE #2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS, (Continued)*

	2007	2006
Cash and cash equivalents	\$ 34,422	\$ 39,267
Assets whose use is limited	59,019	59,028
Total Cash and Investments	<u>\$ 93,441</u>	<u>\$ 98,295</u>

The Medical Center's cash and investments as of June 30, 2007 and 2006 consisted of the following:

	2007	2006 as restated
Deposits with County Treasury	\$ 34,422	\$ 39,267
Investments	59,019	59,028
Total Cash and Investments	<u>\$ 93,441</u>	<u>\$ 68,295</u>

**Investments Authorized by Debt Agreements**

Investment of debt proceeds and reserves held by bond trustees are governed by provisions of the trust agreements created in connection with the issuance of debt (see Note #9), rather than the general provisions of the California Government Code. The Medical Center's bond reserves are held in money market mutual funds, U.S. Treasury Securities, and guaranteed investment contracts.

**Interest Rate Risk**

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The Medical Center's investments held by bond trustees are monitored for interest rate risk by measuring the weighted average maturity.

Investment Type	Fair Value at June 30, 2007	Weighted Average Maturity (in years)
Held by bond trustee:		
Money market mutual funds	\$ 2,091	daily
Guaranteed investment contracts	34,506	10.53
U.S. Treasury Notes	22,422	15.39
Total	<u>\$ 59,019</u>	

COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2007 AND 2006

(Dollar Amounts in Thousands)

NOTE #2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS, (Continued)

**Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations**

The Medical Center's investments held with bond trustees include the following investment that is highly sensitive to interest rate fluctuations (to a greater degree than already indicated in the information provided above) as of June 30, 2007 and 2006:

<u>Highly Sensitive Investments</u>	<u>Fair Value at June 30, 2007</u>
Interest only Treasury strips. The fair value of these investments are closely associated with the present value of the expected stream of cash flows from interest payments made to maturity. Accordingly, the fair value of these securities are highly sensitive to change in market interest rates that might lead to dramatic changes in expected cash flows.	\$ 271

<u>Highly Sensitive Investments</u>	<u>Fair Value at June 30, 2006</u>
Interest only Treasury strips. The fair value of these investments are closely associated with the present value of the expected stream of cash flows from interest payments made to maturity. Accordingly, the fair value of these securities are highly sensitive to change in market interest rates that might lead to dramatic changes in expected cash flows.	\$ 254

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

*NOTE #2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS, (Continued)*

**Credit Risk**

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating (where applicable) required by the California Government Code, the Medical Center's investment policy, or debt agreements and the actual rating for each investment type as of June 30, 2007 and 2006:

Investment Type	Rating as of June 30, 2007		
	AAA	AA2	A1+
Held by bond trustee:			
Money market mutual funds	\$ 2,091	\$ 2,091	
Guaranteed investment contracts	34,506	\$ 34,506	
U.S. Treasury Bonds	22,422		\$ 22,422
Total	<u>\$ 59,019</u>	<u>\$ 2,091</u>	<u>\$ 22,422</u>

Investment Type	Rating as of June 30, 2006		
	AAA	AA2	A1+
Held by bond trustee:			
Money market mutual funds	\$ 2,176	\$ 2,176	
Guaranteed investment contracts	34,507	\$ 34,507	
U.S. Treasury Bonds	22,345		\$ 22,345
Total	<u>\$ 59,028</u>	<u>\$ 2,176</u>	<u>\$ 22,345</u>



**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

*NOTE #2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS, (Continued)*

**Concentration of Credit Risk**

Concentration of credit risk is the risk of loss attributed to the magnitude of investment in a single issuer. Investments in any one issuer that represent five percent or more of the Medical Center's total investments are shown below as of June 30, 2007 and 2006:

Issuer	Investment Type	Fair Value at June 30, 2007
FSA Capital Management	Guaranteed Investment Contract	\$ 12,790
CDC Funding Corp.	Guaranteed Investment Contract	12,009
MBIA Investment Management Corp.	Guaranteed Investment Contract	9,707
		<u>\$ 34,506</u>

Issuer	Investment Type	Fair Value at June 30, 2006
FSA Capital Management	Guaranteed Investment Contract	\$ 12,690
CDC Funding Corp.	Guaranteed Investment Contract	12,110
MBIA Investment Management Corp.	Guaranteed Investment Contract	9,707
		<u>\$ 34,507</u>

**Custodial Credit Risk**

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the County Treasurer's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law. The market value of the pledged securities in the collateral pool must equal at least 110 percent of the total amount deposited by the public agencies. California law also allows financial institutions to secure deposits by pledging first trust deed mortgage notes having a value of 150 percent of the secured public deposits.

GASB Statement No. 40 requires that disclosure be made with respect to custodial credit risks relating to deposits. The Medical Center did not have any cash with fiscal agent in excess of federal depository insurance limits held in uncollateralized accounts at June 30, 2007 and 2006.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

*NOTE #3 – STATE REALIGNMENT FUNDING*

The State of California provides support to the Medical Center through a realignment fund. This realignment funding is provided from vehicle license fees and sales tax collected at the state level and allocated to California's counties. The realignment fund replaces state support previously given for specific purposes such as aid to local municipalities affected by decreased levels of tax support, aid to counties which provide services to medically indigent adults, and aid for unreimbursed medical costs of legalized indigent aliens. The amount to be received by the counties is dependent upon the actual change in sales tax and vehicle license fees. The Medical Center's share of these revenues for the years ended June 30, 2007 and 2006, as restated was \$46,387 and \$69,283, respectively. Because the revenues received are not based upon services provided to patients, they have been classified as nonoperating revenue in the accompanying statements of revenues, expenses, and changes in net assets.

*NOTE #4 – NET PATIENT SERVICE REVENUE*

The Medical Center provides services to eligible patients under Medi-Cal and Medicare programs. For the fiscal years ended June 30, 2007 and 2006, the Medi-Cal program represented approximately 33 percent and 38 percent, respectively, and the Medicare program represented approximately 16 percent and 18 percent, respectively, of the Medical Center's net patient service revenue. Medi-Cal inpatient services are reimbursed at contractually agreed-upon per diem rates and outpatient services are reimbursed under a schedule of maximum allowances. Medicare inpatient services are reimbursed based upon pre-established rates for diagnostic-related groups. Effective August 1, 2000, outpatient services went from a cost reimbursement payment methodology to prospectively determined payments per procedure under a system called Ambulatory Payment Classifications. Certain defined capital and medical education costs related to Medicare beneficiaries continue to be paid based on a cost-reimbursement methodology. The Medical Center is reimbursed for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the fiscal intermediary. The Medical Center's classification of patients under these programs and the appropriateness of their admissions are subject to an independent review by a peer review organization under contract with the Medical Center. Reports on the results of such audits have been received through June 30, 2003 for Medicare and June 30, 2004, for Medi-Cal. Adjustments as a result of such audits are recorded in the year the amounts can be determined.

**Medi-Cal Waiver** – The federal Medicaid program is referred to as Medi-Cal in California. Effective July 1, 2005 Medi-Cal fee-for-service (FFS) inpatient hospital payments are made in accordance with the federal Medicaid hospital financing waiver and State of California Senate Bill 1100 (SB 1100). Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. SB 1100 is designed to protect baseline Medi-Cal funding for the Medical Center over the next five years – at a minimum the Medical Center will receive the Medi-Cal inpatient hospital payments they received in 2004-05 adjusted for future utilization changes.

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**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

*NOTE #4 – NET PATIENT SERVICE REVENUE, (Continued)*

SB 1100 also allows the Medical Center to receive additional waiver growth funding subject to the availability of funds. The total payments made to the Medical Center under SB 1100 will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share (DSH) payments, and Safety Net Care Pool (SNCP). The SNCP is a new federal allotment available under the waiver. For the year ended June 30, 2007 and 2006, the Medical Center recorded total Medi-Cal inpatient and outpatient revenue of \$122,106 and \$100,356, respectively and related receivable of \$9,818 and \$8,669, respectively.

**Assembly Bill 915** - California's Assembly Bill 915 (SB-915) was passed by the State Legislature and signed into law in 2002. This bill provides for the payment of a supplemental reimbursement to acute care hospitals owned by certain public entities that provide outpatient services to Medi-Cal beneficiaries. The Medical Center recorded \$7,380 and \$6,256 in AB-915 funds for the years ended June 30, 2007 and 2006, respectively. Because the revenues generated are based upon services provided to patients, they have been classified as net patient service revenue in the accompanying statements of revenues, expenses, and changes in net assets. The Medical Center recorded receivables of -\$0- and \$421 for the years ended June 30, 2007 and 2006, respectively, which were included in receivable from other governments.

*NOTE #5 – CHARITY CARE*

The Medical Center maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The following information measures the level of charity care provided during the fiscal years ended June 30:

	2007	2006
Charges foregone based on established rates	<u>\$ 324,538</u>	<u>\$ 337,522</u>

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**NOTES TO FINANCIAL STATEMENTS**

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**(Dollar Amounts in Thousands)**

***NOTE #6 – CAPITAL CONTRIBUTIONS***

In 1991, the County Board of Supervisors approved the construction and financing plan of the Arrowhead Regional Medical Center project. The Inland Empire Public Facilities Corporation (Corporation) financed the project through the issuance of Certificates of Participation. The Corporation is a nonprofit public benefit corporation formed on May 30, 1986, to serve the County, including the Medical Center, by financing, refinancing, acquiring, constructing, improving, leasing, and selling buildings, building improvements, equipment, land, land improvements, and any other real or personal property for the benefit of the residents of the County. The Corporation is included in the County's reporting entity as a blended component unit. In fiscal year 1999, the Medical Center Project assets and liabilities were contributed to the Medical Center.

In accordance with the master lease agreement, the County is obligated to make aggregate lease payments each year as consideration for the use and occupancy of the Medical Center in an amount designated to be sufficient to pay the annual principal and interest due with respect to any construction debt outstanding. Senate Bill 1732 (SB-1732) was passed by the California Legislature and signed into law in October 1998. The law permits qualifying medical centers to receive reimbursement, in addition to their Medi-Cal contract reimbursement, for a portion of the debt service of qualified projects. Under SB-1732, the Medical Center estimates that it will receive proceeds equal to 50 percent of the total debt service costs. Amounts received by the Medical Center in SB-1732 funds during fiscal years 2007 and 2006 amounted to \$26,594 and \$21,521, respectively, which are included as nonoperating revenues in the accompanying statements of revenues, expenses, and changes in net assets. The Medical Center had no related receivables at June 30, 2007 and 2006.

**COUNTY OF SAN BERNARDINO  
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**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

*NOTE #7 – CAPITAL ASSETS*

A summary of capital assets activity for the years ended June 30, 2007 and 2006, is as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
June 30, 2007				
Land and improvements	\$ 22,292	\$ 949		\$ 23,241
Buildings and improvements	491,248	389		491,637
Equipment	97,728	4,568		102,296
Construction-in-progress	368	4,092	\$ 1,692	2,768
Total Capital Assets, Gross	611,636	9,998	1,692	619,942
Accumulated Depreciation:				
Land and improvements	(55)	(19)		(74)
Buildings and improvements	(89,535)	(12,305)		(101,840)
Equipment	(78,950)	(5,928)		(84,878)
Total Accumulated Depreciation	(168,540)	(18,252)		(186,792)
Capital Assets, Net	<u>\$ 443,096</u>	<u>\$ (8,254)</u>	<u>\$ 1,692</u>	<u>\$ 433,150</u>
June 30, 2006				
Land and improvements	\$ 22,292			\$ 22,292
Buildings and improvements	491,002	\$ 246		491,248
Equipment	95,079	2,707	\$ 58	97,728
Construction-in-progress	617	297	546	368
Total Capital Assets, Gross	608,990	3,250	604	611,636
Accumulated Depreciation:				
Land and improvements	(39)	(16)		(55)
Buildings and improvements	(77,214)	(12,321)		(89,535)
Equipment	(73,100)	(5,904)	(54)	(78,950)
Total Accumulated Depreciation	(150,353)	(18,241)	(54)	(168,540)
Capital Assets, Net	<u>\$ 458,637</u>	<u>\$ (14,991)</u>	<u>\$ 550</u>	<u>\$ 443,096</u>

**COUNTY OF SAN BERNARDINO  
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**NOTES TO FINANCIAL STATEMENTS**

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**(Dollar Amounts in Thousands)**

*NOTE #8 – TRANSACTIONS WITH THE COUNTY*

The Medical Center uses the treasury function of the County and at times maintains a cash overdraft with the County which can be repaid only through collection of receivables. The Medical Center had no cash overdrafts as of June 30, 2007 and 2006.

The Medical Center is allocated a portion of the County's overhead costs. Such expenses totaled \$3,168 and \$2,877 for the years ended June 30, 2007 and 2006, respectively, and are included as operating expense in the accompanying statements of revenues, expenses, and changes in net assets.

The Medical Center is allocated a portion of the County's annual debt service requirement on the County's pension obligation revenue bonds. Such amounts totaled \$6,004 and \$4,513 for the years ended June 30, 2007 and 2006, respectively, and are included in transfers to the County in the accompanying statements of revenues, expenses, and changes in net assets.

The Medical Center also receives funds from the County of a fixed amount for care of the County's medically indigent patients.

*NOTE #9 – LONG-TERM OBLIGATIONS*

The following is a summary of changes in long-term obligations for the fiscal years ended June 30, 2007 and 2006:

	June 30, 2007				
	Beginning Balance	Additions	Reductions	Ending Balance	Due within One Year
Certificates of Participation					
Series 1994	\$ 186,405		\$ (4,515)	\$ 181,890	\$ 3,090
Series 1995	117,160		(6,420)	110,740	8,485
Series 1996	65,070			65,070	
Series 1997	46,815		(14,800)	32,015	15,605
Series 1998	176,510			176,510	
Total Certificates of Participation, Gross	591,960		(25,735)	566,225	27,180
Less:					
Deferred amount on refunding	(37,851)		1,807	(36,044)	
Discount on debt	(13,056)		434	(12,622)	
Total Certificates of Participation	541,053		(23,494)	517,559	27,180
Capital lease obligations	2,438	\$ 3,042	(1,344)	4,136	1,665
Total	\$ 543,491	\$ 3,042	\$ (24,838)	\$ 521,695	\$ 28,845

**COUNTY OF SAN BERNARDINO  
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**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

**NOTE #9 – LONG-TERM OBLIGATIONS, (Continued)**

	June 30, 2006				
	Beginning Balance	Additions	Reductions	Ending Balance	Due within One Year
Certificates of Participation					
Series 1994	\$ 190,875		\$ (4,470)	\$ 186,405	\$ 4,515
Series 1995	123,035		(5,875)	117,160	6,420
Series 1996	65,070			65,070	
Series 1997	60,820		(14,005)	46,815	14,800
Series 1998	176,510			176,510	
Total Certificates of Participation, Gross	616,310		(24,350)	591,960	25,735
Less:					
Deferred amount on refunding	(39,659)		1,808	(37,851)	
Discount on debt	(13,491)		435	(13,056)	
Total Certificates of Participation	563,160		(22,107)	541,053	25,735
Capital lease obligations	1,306	1,648	(517)	2,438	844
Total	\$ 564,466	\$ 1,648	\$ (22,624)	\$ 543,491	\$ 26,579

**A. Certificates of Participation**

The Medical Center's certificates of participation were issued by the Inland Empire Public Facilities Corporation (Corporation).

Certificates of participation at June 30, 2007 consist of the following:

**Series 1994**

The Medical Center Series 1994 Certificates of Participation were dated February 1, 1994, in the amount of \$283,245, with interest rates from 4.60 percent to 7.00 percent.

The Series 1994 Certificates maturing on August 1, 2007, August 1, 2019, August 1, 2024, August 1, 2026, and August 1, 2028, are subject to optional redemption in whole or in part on any date in such order of maturity as the Corporation shall determine and by lot within a maturity, on or after August 1, 2004, at the following premiums, plus interest accrued to the redemption date:

Redemption Dates	Premium
August 1, 2007 and thereafter	-

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**NOTES TO FINANCIAL STATEMENTS**

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**NOTE #9 – LONG-TERM OBLIGATIONS, (Continued)**

The Series 1994 Certificates maturing on August 1, 2009, August 1, 2017, August 1, 2020, and August 1, 2022, are not subject to optional redemption prior to maturity.

**Series 1995**

The Series 1995 Certificates of Participation were dated June 1, 1995, in the amount of \$363,265, with interest rates from 4.80 percent to 7.00 percent.

The Series 1995 Certificates maturing on August 1, 2022, are subject to optional redemption, in whole or in part, on any date in such order of maturity as the Corporation shall determine and by lot within a maturity, on or after August 1, 2006, at the following premiums, plus interest accrued to the redemption date:

<u>Redemption Dates</u>	<u>Premium</u>
July 1, 2007 to July 31, 2007	1%
August 1, 2007 and thereafter	-

The Series 1995 Certificates maturing on and prior to August 1, 2010 and on August 1, 2017, are not subject to optional redemption prior to maturity.

**Series 1996**

The Series 1996 Certificates of Participation were dated January 1, 1996, in the amount of \$65,070, with interest rates from 5.00 percent to 5.25 percent.

The Series 1996 Certificates are subject to optional redemption, in whole or in part, on any date in such order of maturity as the Corporation shall determine and by lot within a maturity, on or after August 1, 2007, at the following premiums, plus interest accrued to the redemption date:

<u>Redemption Dates</u>	<u>Premium</u>
August 1, 2007 to July 31, 2008	1%
August 1, 2008 and thereafter	-

**Series 1997**

The Series 1997 Certificates of Participation were dated September 1, 1997, in the amount of \$121,095, with interest rates from 4.30 percent to 5.50 percent.

The Series 1997 Certificates are not subject to optional redemption prior to maturity.



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**NOTES TO FINANCIAL STATEMENTS**

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**NOTE #9 – LONG-TERM OBLIGATIONS, (Continued)**

**Series 1998**

The Series 1998 Certificates of Participation were dated October 22, 1998, in the amount of \$176,510. Interest with respect to the Certificates is payable at an adjustable weekly interest rate, which may be converted to a fixed interest rate at the option of the Corporation. The Corporation entered into an interest rate swap agreement with Merrill Lynch Capital Services, Inc., which provides that the Corporation will pay a fixed rate of 4.1895 percent to the Swap Provider on a notional amount equal to the principal amount of the Series 1998 Certificates, and the Swap Provider will pay interest to the Corporation at a variable rate of interest on such notional amount, such payments to be made on a net basis. See information below.

The Series 1998 Certificates are subject to optional redemption prior to their maturity at a redemption price equal to the principal amount thereof, plus accrued interest to the date of redemption as follows:

- a) Prior to the Conversion Date to fixed interest rate, at a redemption price equal to the principal amount called for redemption without premium.
- b) After the Conversion Date, at a redemption price of 100 percent of the principal amount plus a premium to be determined on or prior to the Conversion Date.

The proceeds from the Series 1998 Certificates of Participation (Certificates) were used for the advance refunding for \$160,700 of previously issued Series 1995 Certificates of Participation. Government securities were purchased with the proceeds, and those securities were deposited in an irrevocable trust with an escrow agent to provide debt service until the remaining outstanding Certificates mature. The advance-refunding method met the requirements of an in-substance defeasance, and the remaining outstanding Certificates were removed as a liability of the Medical Center.

At both June 30, 2007 and 2006, the balance of defeased debt outstanding, but removed from the Medical Center's financial statements was \$61,070 and \$61,070, respectively.

**Interest Rate Swap**

*Objective of the interest rate swap.* As a means to lower financing costs, and to reduce the risks to the Corporation associated with the fluctuation in market interest rates, the Corporation entered into an interest rate swap in connection with the Medical Center Series 1998 Certificates of Participation (Series 1998 Certificates) in the amount of \$176,510. The intention of the swap was to effectively change the variable interest rate on the bonds to a synthetic fixed-rate of 4.1895 percent.

**COUNTY OF SAN BERNARDINO  
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**NOTES TO FINANCIAL STATEMENTS**

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**NOTE #9 – LONG-TERM OBLIGATIONS, (Continued)**

*Terms.* The Series 1998 Certificates and the related swap agreement mature on August 1, 2026, and the swap's notional amount of \$176,510 matches the \$176,510 variable-rate COPs. The swap was effective at the same time the Series 1998 Certificates were issued on October 22, 1998. Starting in fiscal year 2008-09, the notional value of the swap and the principal amount of the associated debt should decline. Under the swap agreement, through August 1, 2006, the Corporation pays Merrill Lynch a fixed rate of 4.1895 percent and Merrill Lynch pays the Corporation an amount equal to the variable rate interest payable on the outstanding Series 1998 Certificates. After August 1, 2006, the Corporation pays Merrill Lynch a fixed payment of 4.1895 percent and receives from Merrill Lynch a variable payment computed as 73 percent of the monthly London Interbank Offered Rate (LIBOR). Conversely, the Series 1998 Certificates variable-rate coupons have historically been similar to the Bond Market Association Municipal Swap Index (BMA).

*Fair Value.* Because interest rates have increased since execution of the swap, the swap had a positive fair value of \$436 as of June 30, 2007. The swap's positive fair value may be countered by an increase in total anticipated future interest payments required under the variable-rate bonds, creating a higher synthetic interest rate. Because the coupons on the variable-rate Series 1998 Certificates adjust to changing interest rates, the Series 1998 Certificates do not have a corresponding fair value increase. The fair value was the quoted market price from Merrill Lynch at June 30, 2007.

*Credit Risk.* The swap counterparty was rated Aa3 by Moody's and A+ by Standard & Poor as of June 30, 2007. The swap agreement specifies that if the long-term senior unsecured debt rating of Merrill Lynch & Co. is withdrawn, suspended or falls below A- (Standard & Poor) or A3 (Moody's), a collateral agreement will be executed within 30 days or the swap agreement will terminate.

*Basis Risk.* The swap exposes the Corporation to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the Series 1998 Certificates. If a change occurs that results in the rates moving to convergence, the expected cost savings may not be realized. As of June 30, 2007, the BMA rate was 3.97 percent, the actual variable interest rate was 3.87 percent, and 73 percent of LIBOR was 3.89 percent.

*Termination Risk.* The Corporation or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. The swap may be terminated by the Corporation if Merrill Lynch's credit quality rating falls below A- as issued by Standard & Poor or A3 by Moody's. If the swap is terminated, the variable-rate Series 1998 Certificates would no longer carry a synthetic interest rate. Also, if at the time of termination the swap has a negative fair value, the Corporation would be liable to Merrill Lynch for a payment equal to the swap's fair value.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

**NOTE #9 – LONG-TERM OBLIGATIONS, (Continued)**

*Swap payments and associated debt.* Using rates as of June 30, 2007, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable rate Series 1998 Certificates interest payments and net swap payments will vary.

Fiscal Year	Variable Rate Bonds		Interest Rate Swaps, Net	Total
	Principal	Interest		
2008		\$ 6,407	\$ 540	\$ 6,947
2009	\$ 1,000	6,389	538	7,927
2010	1,100	6,351	535	7,986
2011	1,200	6,309	532	8,041
2010	9,200	6,121	516	15,837
2013-2027	164,010	50,404	4,248	218,662
Totals	<u>\$ 176,510</u>	<u>\$ 81,981</u>	<u>\$ 6,909</u>	<u>\$ 265,400</u>

**B. Debt Service Requirements**

The total annual debt service requirements to maturity for the outstanding Certificates of Participation as of June 30, 2007 are summarized as follows:

Fiscal Year	Total	
	Principal	Interest
2008	\$ 27,180	\$ 28,247
2009	29,795	26,670
2010	14,610	25,355
2011	15,635	24,378
2012	16,580	23,466
2013-17	96,705	103,685
2018-22	125,900	75,083
2023-27	162,500	38,725
2028-30	77,320	3,843
Totals	<u>\$ 566,225</u>	<u>\$ 349,451</u>

**COUNTY OF SAN BERNARDINO  
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**NOTES TO FINANCIAL STATEMENTS**

**JUNE 30, 2007 AND 2006**

**(Dollar Amounts in Thousands)**

*NOTE #9 – LONG-TERM OBLIGATIONS, (Continued)*

**C. Capital Lease Obligations**

The Medical Center has various lease agreements with financial institutions and medical equipment manufacturers expiring at various dates through November 2009, providing for monthly payments at various interest rates. Equipment acquired under these agreements have been accounted for as capital leases.

Future minimum lease payments on capital leases as of June 30, 2007, are as follows:

<u>Fiscal Year</u>	
2008	\$ 1,802
2009	1,363
2010	1,213
Total minimum lease payments	<u>4,378</u>
Less Amount Representing Interest	<u>(242)</u>
Present value of net minimum lease payments	4,136
Less Current Portion of Capital Lease Obligations	<u>(1,665)</u>
Capital lease obligations, excluding current portion	<u>\$ 2,471</u>

The net book value of equipment acquired under capitalized leases at June 30, 2007 and 2006 was \$4,903 and \$2,514, net of accumulated amortization of \$5,083 and \$4,042, respectively.

*NOTE #10 – ARBITRAGE PAYABLE*

Interest earned in excess of interest expense related to tax-exempt debt issued for public purposes must be remitted to the federal government following the end of each period of five bond years of the Certificates of Participation. The amount of excess investment earnings calculated as of June 30, 2007 and 2006, totaled \$264 and \$191, respectively.

*NOTE #11 – OPERATING LEASES*

Rent expense for operating leases for the years ended June 30, 2007 and 2006, totaled \$4,650 and \$3,758, respectively.

**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**NOTES TO FINANCIAL STATEMENTS**

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**(Dollar Amounts in Thousands)**

**NOTE #12 – RETIREMENT PLAN**

Employees of the Medical Center participate in a cost-sharing multiple-employer defined benefit retirement plan (the Plan) administered by the San Bernardino County Employee's Retirement Association (SBCERA). The Plan is governed by the San Bernardino Board of Retirement under the California County Employees Retirement Act of 1937 (1937 Act). It provides retirement, death, and disability benefits to members. Employees become eligible for membership on their first day of regular employment and become fully vested after five years. SBCERA issues a stand-alone financial report, which may be obtained by contacting the Board of Retirement, 348 W. Hospitality Lane, 3<sup>rd</sup> floor, San Bernardino, California 92415-0014.

Participating members are required by statute (Sections 31621, 31621.2, and 31639.25 of the California Code) to contribute a percentage of covered salary based on certain actuarial assumptions and their age at entry into the Plan. Employee contribution rates vary according to age and classification (general or safety). Members are required to contribute 8.98 percent to 15.09 percent of their annual covered salary, of which the County pays approximately 7 percent. Employers are required to contribute 12.24 percent to 47.40 percent of the current year covered payroll. The Medical Center's pension cost for the fiscal years ended June 30, 2007 and 2006, was approximately \$27,838 and \$22,232, respectively. Employee contribution rates are established and may be amended pursuant to Articles 6.1 and 6.8 of the 1937 Act. Employer rates are determined pursuant to Section 31453 of the 1937 Act. The following table shows the County's required contributions and the percentage contributed for the current year and each of the two preceding years:

<u>Year Ended June 30,</u>	<u>County's Annual Required Contributions</u>	<u>Percentage Contributed</u>
2005	\$ 141,450	100%
2006	166,614	100%
2007	194,130	100%

**NOTE #13 – SELF-INSURANCE**

The Medical Center participates in the County's self-insurance programs for general liability, unemployment insurance, employee dental insurance, medical malpractice, and workers' compensation claim-related risks.

The activities related to the self-insurance programs are accounted for in the County's Risk Management Funds, separate internal service funds of the County, except for unemployment insurance and employee dental insurance, which are accounted for in the General Fund of the County. The Medical Center participates in these plans through a premium based arrangement that consists of annual amounts not subject to adjustment for adverse claims. Insurance premium expense for the years ended June 30, 2007 and 2006 was \$7,741 and \$8,839, respectively.

**COUNTY OF SAN BERNARDINO  
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**NOTES TO FINANCIAL STATEMENTS**

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**(Dollar Amounts in Thousands)**

*NOTE #14 – LITIGATION*

The Medical Center is the defendant in various lawsuits and other claims arising in the ordinary course of its operations. In the opinion of County Counsel and County officials, the ultimate outcome of these matters will have no significant effect on the financial condition or operations of the Medical Center.

*NOTE 15—PRIOR PERIOD ADJUSTMENT*

During the current year, it was determined that a transfer of realignment funding from the County of San Bernardino to the Medical Center to fund the 6<sup>th</sup> Floor Project totaling \$30,000,000 was incorrectly recorded to the County of San Bernardino's Capital Projects Fund instead of being recorded as realignment revenue in the Medical Center's Statement of Revenues and Changes in Net Assets as of June 30, 2006. To correct this error, cash and cash equivalent and realignment revenue reported as of June 30, 2006 have been restated and the beginning net assets of the Medical Center's net assets (liabilities) balance of \$(9,425), as originally reported, has been increased to \$20,575.



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE  
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

The Honorable Board of Supervisors  
County of San Bernardino, California

We have audited the financial statements of Arrowhead Regional Medical Center (the Medical Center) a component unit of the County of San Bernardino, California, as of and for the year ended June 30, 2007 and 2006, and have issued our report thereon dated September 20, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the Medical Center's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Medical Center's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Medical Center's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Medical Center's financial statements that is more than inconsequential will not be prevented or detected by the Medical Center's internal control. We consider the deficiency described in the accompanying schedule of findings and responses as item 2007-01 to be a significant deficiency in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Medical Center's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Medical Center in a separate letter dated November 27, 2007.

The Medical Center's response to the finding identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the Medical Center's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Supervisors, Audit Committee, medical center management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

*Vavermik, Time, Day :! Co., LLP*

Rancho Cucamonga, California  
November 27, 2007



**COUNTY OF SAN BERNARDINO  
ARROWHEAD REGIONAL MEDICAL CENTER**

**SCHEDULE OF FINDINGS AND RESPONSES**

**JUNE 30, 2007**

The following findings represent significant deficiencies, material weaknesses, or instances of noncompliance related to the financial statements that are required to be reported in accordance with generally accepted government auditing standards:

**Finding 2007-01 - Restatement of Prior Year Financial Statements**

**Criteria:**

Financial statements prepared in accordance with generally accepted accounting principles in the United States of America should report assets, liabilities, revenues and expenses of the entity in the period the underlying transaction occurs or accrues to the entity.

**Condition:**

During the current year, the County determined that a transfer of realignment funding from the County of San Bernardino General Fund to the Medical Center to fund the 6<sup>th</sup> Floor Project totaling \$30,000,000 was incorrectly recorded to the County of San Bernardino's Capital Projects Fund instead of being recorded as realignment revenue in the Medical Center's Statement of Revenues and Changes in Net Assets as of June 30, 2006.

It is noted the County's Administrative Office prepared and approved the transfer of funds document. However, it is further noted the Auditor-Controllers Office's existing internal controls designed to review and approve transfers requests prior to recording in FAS did not detect the fund coding error, resulting in the misstatement.

**Context:**

The Medical Center's net assets were understated by \$30 million at June 30, 2006.

**Effect:**

To correct this error, cash and cash equivalent and realignment revenue reported as of June 30, 2006 have been restated and the beginning net assets of the Medical Center's net assets (liabilities) balance of \$(9,425), as originally reported, has been increased to \$20,575.

**Recommendation:**

We commend the County for implementing stronger internal controls to ensure transfer requests are properly recorded. The Auditor/Controller-Recorder office established a dollar threshold that requires additional review and approval before recording the transaction. We recommend that the County consider establishing a dollar threshold that would require manager approval both within the originating department and the destination department.

**View of responsible officials:**

The County concurs and implemented new preventive controls on July 5, 2007 at the Auditor/Controller-Recorder's office. The control requires either the General Accounting Manager or Supervisor's review, approval, and sign-off of all journal entries or transfers equal to or greater than \$1,000,000 dollars. For amounts equal to or greater than \$10,000,000, the signature of the Chief Deputy Controller, equivalent or higher is required.